

~~THE CALIFORNIA PUBLIC EMPLOYEES'~~
~~RETIREMENT SYSTEM~~

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~~GLOBAL PRINCIPLES~~
~~of~~
~~ACCOUNTABLE CORPORATE GOVERNANCE~~
~~Updated March 12, 2007~~

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~~"Everywhere shareholders are re-examining their relationships with company bosses — what is known as their system of 'corporate governance.' Every country has its own, distinct brand of corporate governance, reflecting its legal, regulatory and tax regimes... The problem of how to make bosses accountable has been around ever since the public limited company was invented in the 19th century, for the first time separating the owners of firms from the managers who run them...."~~

~~"Corporate Governance: Watching the Boss," THE ECONOMIST 3 (Jan. 29, 1994).~~

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~~California Public Employees' Retirement System~~
~~Lincoln Plaza — 400 Q Street — Sacramento, CA 95814~~

I. INTRODUCTION

The California Public Employees' Retirement System (CalPERS) is the largest U.S. public pension fund, with assets totaling \$210 billion spanning domestic and international markets as of July 31, 2006. ***Our mission is to advance the financial and health security for all who participate in the System. We will fulfill this mission by creating and maintaining an environment that produces responsiveness to all those we serve.*** This statement was adopted by the CalPERS Board of Administration to guide us in serving our more than 1.4 million members and retirees.

The CalPERS Board of Administration is guided by the Board's Investment Committee, management, and more than 180 Investment Office staff who carry out the daily activities of the investment program. Our goal is to efficiently and effectively manage investments to achieve the highest possible return at an acceptable level of risk. In doing so, CalPERS has generated strong long-term returns.

CalPERS' Corporate Governance¹ Program is a product of the evolution that only experience and maturity can bring. In its infancy in 1984-87, corporate governance at CalPERS was solely reactionary: reacting to the anti-takeover actions of corporate managers that struck a dissonant chord with one's sense—as owners of the corporate entity—of accountability and fair play. The late 1980s and early 1990s represented a period in which CalPERS learned a great deal about the “rules of the game”—how to influence corporate managers, what issues were likely to elicit fellow shareowner support, and where the traditional modes of shareowner/corporation communication were at odds with current reality.

Beginning in 1993, CalPERS turned its focus toward companies considered by virtually every measure to be “poor” financial performers. By centering its attention and resources in this way, CalPERS could demonstrate to those who questioned the value of corporate governance very specific and tangible economic results.²

What have we learned over the years? We have learned that (a) company managers want to perform well, in both an absolute sense and as compared to their peers; (b) company managers want to adopt long-term strategies and visions, but often do not feel that their shareowners are patient enough; and (c) all companies—whether governed

¹ “Corporate Governance,” at CalPERS, means the “relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) shareowners, (2) management (led by the chief executive officer), and (3) the board of directors.” (Robert Monks and Nell Minow, CORPORATE GOVERNANCE 1 (1995).)

² See Steven L. Nesbitt, “Long-Term Rewards from Shareholder Activism: A Study of the ‘CalPERS Effect,’” J. OF APP. CORP. FIN. 75 (Winter 1994): Concluding that CalPERS’ program generates approximately \$150 million, per year, in added returns. See Mark Anson, Ted White, and Ho Ho “Good Corporate Governance Works: More Evidence from CalPERS,” Journal of Asset Management, Vol. 5, 3 (February 2004), 149-156. Also see “The Shareholder Wealth Effects of CalPERS’ Focus List,” Journal of Applied Corporate Finance, (Winter 2003), 8-17: The authors found that between 1992 and 2002, publication of the CalPERS “Focus List” and efforts to improve the corporate governance of companies on that list generated one-year average cumulative excess returns of 59.4%. Cumulative excess return is the cumulative “return earned over and above the risk-adjusted return required for each public corporation.”

~~under a structure of full accountability or not — will inevitably experience both ascents and descents along the path of profitability.~~

~~We have also learned, and firmly embrace the belief that good corporate governance — that is, accountable governance — means the difference between wallowing for long periods in the depths of the performance cycle, and responding quickly to correct the corporate course.~~

~~As one commentator noted:~~

~~*“Darwin learned that in a competitive environment an organism’s chance of survival and reproduction is not simply a matter of chance. If one organism has even a tiny edge over the others, the advantage becomes amplified over time. In ‘The Origin of the Species,’ Darwin noted, ‘A grain in the balance will determine which individual shall live and which shall die.’ I suggest that an independent, attentive board is the grain in the balance that leads to a corporate advantage. A performing board is most likely to respond effectively to a world where the pace of change is accelerating. An inert board is more likely to produce leadership that circles the wagons.”*~~

~~Ira M. Millstein, New York Times, April 6, 1997, Money & Business Section, p. 10.~~

II. PURPOSE

~~The Global Principles of Accountable Corporate Governance (“Global Principles”) create the framework by which CalPERS executes its proxy voting responsibilities in addition to providing a foundation for supporting the System’s corporate engagement and governance initiatives in international developed and emerging capital markets. CalPERS implements its proxy voting responsibility and corporate governance initiatives in a manner that is consistent with the Global Principles unless such action may result in long-term harm to the company that outweighs all reasonably likely long-term benefit or unless such a vote is contrary to the interests of the beneficiaries of CalPERS’ system.~~

~~The execution of proxies and voting instructions is the primary means by which shareowners can influence a company’s operations and corporate governance. It is therefore important for shareowners to exercise their voting rights, making their decisions based on a full understanding of the information and legal documentation presented to them. CalPERS will vote in favor of or “For”, an individual or slate of director nominees up for election that the System believes will effectively oversee CalPERS’ interests as a shareowner consistent with the Global Principles.~~

~~However, CalPERS will withhold its vote from or vote “Against” an individual or slate of director nominees at companies that do not effectively oversee CalPERS’ interests as a shareowner consistent with the Global Principles or in limited circumstances where a company has consistently demonstrated long-term economic underperformance.~~

~~At a minimum, CalPERS believes the criteria contained in the Global Principles are important considerations for all companies within the global market, especially those companies in developed markets. However, CalPERS recognizes that the adoption of the Global Principles in its entirety may not be appropriate for every company, especially~~

those companies in emerging capital markets, due to differing developmental stages, ownership structure, competitive environment, or a myriad of other distinctions.

By adopting the Global Principles of Accountable Governance that follow, CalPERS strives to influence the market through advancing the corporate governance dialogue while also providing an educational forum by representing a foundation for accountability between a corporation's management and its owners.

III. GLOBAL PRINCIPLES of ACCOUNTABLE CORPORATE GOVERNANCE

The underlying tenet for CalPERS' Global Principles of Accountable Governance is that fully accountable governance structures produce, over the long term, the best returns to shareowners. In general, CalPERS' Global Principles encompass the following:

1. Corporate governance practices should focus board attention on optimizing over time the company's operating performance and returns to shareowners.
2. Directors should be accountable to shareowners, and management accountable to directors. To ensure this accountability, directors must be accessible to shareowner inquiry concerning their key decisions affecting the company's strategic direction.
3. Information about companies must be readily transparent to permit accurate market comparisons; this includes disclosure and transparency of objective globally accepted minimum accounting standard.
4. All investors must be treated equitably and upon the principle of one share/one vote.
5. Proxy materials should be written in a manner designed to provide shareowners with the information necessary to make informed voting decisions. Similarly, proxy materials should be distributed in a manner designed to encourage shareowner participation. All shareowner votes, whether cast in person or by proxy, should be formally counted; vote outcomes should be formally announced.
6. Each capital market in which shares are issued and traded should adopt its own Code of Best Practices; and, where such a code is adopted, companies should disclose to their shareowners whether they comply.
7. Corporate directors and management should have a long-term strategic vision that, at its core, emphasizes sustained shareowner value. In turn, despite differing investment strategies and tactics, shareowners should encourage corporate management to resist short-term behavior by supporting and rewarding long-term superior returns.

A. ICGN GLOBAL CORPORATE GOVERNANCE PRINCIPLES

CalPERS believes that the global governance dialogue will be most advanced through the coalescence of thought around a single set of standards. To that end, CalPERS' Global Principles of Accountable Corporate Governance represent an evolutionary set of

standards that embrace those adopted by the International Corporate Governance Network (ICGN)³.

The ICGN Principles are as follows:

1. Corporate Objective – Shareowner Returns

1.1 Optimizing Return to Shareowners: The overriding objective of the corporation should be to optimize over time the returns to its shareowners. Corporate governance practices should focus board attention on this objective. In particular, the company should strive to excel in comparison with the specific equity sector peer group benchmark. Where other considerations affect this objective, they should be clearly stated and disclosed.

1.2 Long Term Prosperity of the Business: To achieve this objective, the board should develop and implement a strategy for the corporation which improves the equity value over the long term.

2. Disclosure & Transparency

2.1 Objective: Corporations should disclose relevant and material information concerning the corporation on a timely basis, in particular meeting market guidelines where they exist, so as to allow investors to make informed decisions about the acquisition, ownership obligations and rights, and sale of shares.

2.2 Disclosure of Ownership and Voting Rights: In addition to financial and operating results, company objectives, risk factors, stakeholder issuers and governance structures, the information should include a description of the relationship of the company to other companies in the corporate group, data on major shareholders and others that control or may control the company, including information on special voting rights, shareholder agreements, the beneficial ownership of controlling or large blocks of shares, significant cross-shareholding relationships and cross-guarantees as well as information on differential voting rights and related party transactions.

3. Audit

3.1 Accounting Principles: The ICGN supports the development of the highest-quality international accounting and financial reporting standards. The ICGN also supports the harmonization of such standards and encourages corporations to apply those or other standards of comparable quality.

3.2 Audit Independence: Annual audits of the financial statements carried out on behalf of shareholders should be required for all corporations. The audit should be carried out by independent, external auditors who should be proposed by or with the assistance of, the audit committee of the board (or its equivalent where applicable) for approval by shareholders. The corporation's interaction with the

³ The ICGN Global Corporate Governance Principles were revised July 8, 2005 at the annual conference in London, UK.

external auditor should be overseen by the audit committee on behalf of the shareholders. To limit the risk of possible conflicts of interest, non-audit services and fees paid to auditors for non-audit services should be both approved in advance by the audit committee and disclosed in the annual report.

3.3Annual Audit: The annual audit should provide an external and objective opinion that the financial statements fairly represent the financial position and performance of the company in all material respects, give a true and fair view of the affairs of the company and are in compliance with applicable law and regulations as appropriate.

3.4Scope of Audit: The scope of the audit will be as prescribed by applicable law, provided that shareholders should have the right to expand the scope of the audit.

3.5Approval of Financial Statements and Internal Controls: The board of directors, and where required, the appropriate officers of the corporation should affirm on a regular basis (at least annually), the accuracy of the company's financial statements or financial accounts, as appropriate, and the adequacy of its internal controls.

4.Shareholders' Ownership, Responsibilities, Voting Rights, and Remedies

4.1Shareholder Ownership Rights: The exercise of ownership rights by all shareholders should be facilitated, including giving shareholders reasonable notice of all matters in respect of which shareholders are required to or may take action in the exercise of voting rights.

4.2Protections: Boards should treat all corporation's shareholders equitably and should ensure that the rights of all investors, including minority and foreign shareholders, are protected.

4.3Unequal Voting: Corporations' ordinary shares should feature one vote for each share. Corporations should act to ensure the owners' rights to vote. Divergence from a 'one share, one vote' standard which gives certain shareholders power disproportionate to their equity ownership should be both disclosed and justified.

4.4Access to the Vote: The right and opportunity to vote at shareholder meetings hinges in part on the adequacy of the voting system. Markets and companies should facilitate access to the ballot by following the ICGN's *Global Share Voting Principles*. In particular, the ICGN supports initiatives to expand voting options to include the secure use of telecommunication and other electronic channels.

4.5Shareholder Participation in Governance: Shareholders should have the right to participate in key corporate governance decisions, including the right to nominate, appoint and remove directors on an individual basis as well as the external auditor and the right to approve major decisions of the nature referred

to in Section 4.9. Jurisdictions which do not have laws enabling the appointment and removal of a director or an external auditor by shareholders holding a majority of votes should enact them. Companies incorporated in such jurisdictions should nevertheless strive to provide such rights to shareholders.

4.6 Shareholders Right to Call a Meeting of Shareholders: Every corporation should provide holders of a specified portion of the outstanding shares of a corporation, not greater than ten percent (10%), with the right to call a meeting of shareholders for the purpose of transacting the legitimate business of the corporation.

4.7 Shareholder Resolutions: Jurisdictions should enact laws which provide shareholders with the right to put resolutions to a shareholders meeting which may be either advisory to the board of directors or may be binding upon the board of directors depending upon the criteria which must be satisfied by the shareholders putting the resolution.

4.8 Shareholder Questions: Shareholders should be provided with the right to ask questions of the board, management and the external auditor at meetings of shareholders, including questions relating to the board and questions relating to the annual external audit. In addition, shareholders should have the right to receive and discuss the annual audited financial statements of the corporation.

4.9 Major Decisions: Major changes to the core businesses of a corporation and other major corporate changes which may in substance or effect materially dilute the equity or erode the economic interests or share ownership rights of existing shareholders, including major acquisitions and major dispositions and closures of businesses, should not be made without prior shareholder approval of the proposed change. The equity component of compensation schemes for board members and employees should be subject to shareholder approval. Further, corporations should not implement shareholder rights plans or so called “poison pills” without shareholder approval. In addition, changes to the articles or by laws of the corporation should not be made without prior shareholder approval. Shareholders should be given sufficient information about any such corporate changes, in sufficient time to allow them to make informed judgments and exercise their voting rights.

4.10 Duty to Vote: Corporate voting systems should be designed to enable institutional investors to discharge their fiduciary obligation to vote their shares, recognizing the duty of institutional investors to vote their shares responsibly, wherever practicable. Similarly, regulations and laws should facilitate voting rights and should eliminate impediments to cross-border voting.

4.11 Institutional Shareholder Responsibilities: Institutional investors should discharge their responsibilities as shareholders as set out in the ICGN Statement on Institutional Shareholder Responsibilities.

4.12 Consultation amongst Institutional Shareholders: Jurisdictions which do not have laws allowing institutional investors to consult on issues concerning their basic shareholder rights should enact such laws.

4.13 Vote Execution: Votes cast by intermediaries should be cast only in accordance with the instructions of the beneficial owner or his or her authorized agent.

4.14 Record of Ownership of a Corporation's Shares: Every corporation shall maintain a record of the registered owners of its shares and every corporation should be entitled to require such registered owners to provide the corporation with the identity of beneficial owners if the registered owner is not the beneficial owner. Jurisdictions which do not give corporations the right to require registered owners to provide the corporation with the identity of beneficial owners if the registered owner is not the beneficial owner are encouraged to enact laws which give corporations such rights. Corporations should also be entitled to know the identity of the person authorized to vote shares, if that right is exercised by a person other than the registered owner.

4.15 Disclosing Voting Results: Equal effect should be given to votes whether cast in person or in absentia and meeting procedures should ensure that votes are properly counted and recorded. Corporations should make a timely announcement of the outcome of a vote and to implement this recommendation, corporations should publish voting levels for each resolution forthwith following the meeting.

4.16 Shareholder Rights of Action: Shareholders should be afforded rights of action and remedies which are readily accessible in order to redress conduct of a corporation which treats them inequitably. In addition, minority shareholders should be afforded protection and remedies against abusive or oppressive conduct. Jurisdictions with systems of justice which do not effectively afford shareholders the foregoing rights, should facilitate the development of alternative mechanisms for the resolution of disputes involving inequitable, abusive or oppressive treatment of shareholders.

5. Corporate Boards

These Principles do not advocate any particular board structure and the term "board" as used in this document is meant to embrace the different national models of board structures. In the typical two-tier system, "board" as used in the Principles refers to the "supervisory board" while "key executives" refers to the "management board". Although not totally appropriate terminology for a supervisory board in the context of a two-tier board, the term "director" is used to be interchangeable with the term "board member".

5.1 Duties of the Board: The board's duties and responsibilities and key functions, for which they are accountable, include those set out below:

- i. Reviewing, approving and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting

- performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
- ii. Monitoring the effectiveness of the company's governance practices and making changes as needed to ensure the alignment of the corporation's governance system with current best practices.
 - iii. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
 - iv. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.
 - v. Ensuring a formal and transparent board nomination and election process.
 - vi. Monitoring and managing potential conflicts of interest of management, board members, shareholders, external advisors and other service providers, including misuse of corporate assets and abuse in related party transactions.
 - vii. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
 - viii. Overseeing the process of disclosure and communications.

5.2 Director Competencies: The board should ensure that it is made up of directors with the requisite range of skills, knowledge and experience to enable it to discharge its duties and responsibilities.

5.3 Directors are Fiduciaries: Members of the boards of directors or supervisory boards are fiduciaries who must act in the best interests of all of the shareholders or in the best interests of the corporation and are accountable to the shareholder body as a whole. As fiduciaries, directors owe a duty of loyalty to the corporation and must exercise reasonable care in relation to their duties as directors.

5.4 Independent-Minded Directors: One of the principle features of a well-governed corporation is the exercise by its board of directors of independent judgment. Independent judgment means judgment in the best interests of the corporation free of any external influence that may attempt to be or may be or may appear to be exerted on any individual director or the board as a whole.

5.5 Factors Affecting Independence: A common source of influence arises from a relationship which a director has with the corporation, such as a consulting agreement. The potential influence arises because the contract may have been awarded by management. In addition, a significant shareholder may attempt to influence the judgment of a director in the interests of a significant shareholder rather than in the interests of the corporation. Individual directors with relationships to management or to a significant shareholder are by definition not considered to be independent; however, the absence of such relationships does not guarantee independent judgment.

- 5.6 Disclosing the Meaning of Independence:** These Principles do not offer a comprehensive definition of an “independent director.” Such definitions vary from jurisdiction to jurisdiction and reflect different approaches to the drafting of codes of governance. These Principles simply underline the importance of all directors being independent-minded which means exercising objective judgment in the best interests of the corporation in all circumstances regardless of the consequences which such judgment may have for the director personally. However, every corporation should disclose its definition of independence (which should be at least as strict as the requirements of applicable law) and should disclose its determination as to each member of its board of directors whether such member is independent.
- 5.7 Independent Board Members:** Each board should include a strong presence of independent non-executive directors with appropriate competencies including key industry sector knowledge and experience.
- 5.8 Non-Executive Non-Independent Board Members:** Each board may also include a minority of directors who are non-executive directors and who are not independent but who may nevertheless effectively discharge their responsibilities as directors because of, amongst other things, a relationship with the corporation or past experience with the corporation.
- 5.9 Information on Board Members:** Corporations should disclose upon nomination or appointment to the board and thereafter in each annual report or proxy statement information on the identities, core competencies, professional or other backgrounds, recent and current board and management mandates at any other corporations, factors affecting independence, board and committee meeting attendance and overall qualifications of board members and nominees so as to enable investors to weigh the value they add to the company. Information on the appointment procedure should also be disclosed annually.
- 5.10 Election of Directors:** Each director should stand for election on a regular basis and, in any event, at least once every three years and shareholders should be entitled to vote on the election of each director separately.
- 5.11 Board Chairs:** The chair of the board should neither be the CEO nor a former CEO and should be independent on the date of appointment as chair and should not participate in executive compensation plans. The corporation should explain the reasons, if this is not the case, and in such event should adopt an appropriate alternative structure to ensure that the board responsibilities can be effectively discharged in all circumstances, for example by appointing a deputy chair who is independent.
- 5.12 Board Committees:** Where committees of the board are established, their remit, composition, accountability and working procedures should be well-defined and disclosed by the board.

5.13Independent Committees: All corporations should establish the key committees of the board which include the audit, compensation and nomination/governance committees. At least a majority and, preferably all members of the audit committee should be independent. The compensation and nomination/governance committees should be composed of a majority of independent directors.

5.14Related Party Transactions: Every corporation should have a process for reviewing and monitoring any related party transaction. Typically, a committee of independent directors should review every related party transaction to determine whether such transaction is in the best interests of the corporation and if so, ensure that the terms of such transaction are fair to the corporation. The corporation should disclose details of all material related party transactions in the annual report of the corporation.

5.15Director Conflicts of Interest: Corporations should have a process for identifying and managing conflicts of interest directors may have. If a director has an interest in a matter under consideration by the board, then the director and the board should follow that process.

5.16Board Evaluation: Every board of directors should evaluate its performance and the performance of individual directors on a regular basis and should consider engaging an outside consultant to assist in the process. Every corporation should disclose the process for such evaluation.

5.17Non-Executive Director Meeting: Non-executive directors should meet in the absence of executives of the corporation as often as required and on a regular basis.

5.18Share Ownership: Every corporation should have and disclose a policy concerning ownership of shares of the corporation by senior managers and directors with the objective of aligning the interests of the senior managers and directors with the interests of shareholders in a meaningful way.

6. Corporate Remuneration Policies

6.1Aligning Remuneration with the Interests of Shareholders: Corporations should follow the best practices for remuneration set out in the most current policy (Appendix A) of the ICGN.

7. Corporate Citizenship, Stakeholder Relations and the Ethical Conduct of Business

7.1Board Responsibilities and Duties in Relation to Stakeholders: The board is accountable to shareholders and responsible for managing successful and productive relationships with the corporation's stakeholders. The ICGN concurs in the view that active cooperation between corporations and stakeholders is essential in creating wealth, employment and financially sound enterprises over time.

7.2 Compliance with Laws: Corporations should adhere to all applicable laws of the jurisdictions in which they operate.

7.3 Disclosure of Policies: Corporations should disclose their policies on issues involving stakeholders⁴.

7.4 Employee Participation: Corporations are encouraged to develop performance-enhancing mechanisms which align employee interests with shareholder and other stakeholder interests. These include broad-based employee share ownership plans or other profit-sharing programs that are designed to enable employees to share in improved returns to shareholders.

7.5 Corporate Social Responsibility: Corporations should adopt and effectively implement a code of ethics and should conduct their activities in an economically, socially and environmentally responsible manner⁵.

7.6 Integrity: The board is responsible for determining, implementing and maintaining a culture of integrity.

8. Corporate Governance Implementation

8.1 Compliance with and Disclosure of Governance Codes and Systems:

Corporations should comply with a widely recognized national corporate governance code which is generally in line with these ICGN Principles. Where such a code does not exist, investors and others should endeavor to develop a code. Where the ICGN Principles are more rigorous than those of national codes, companies are encouraged to adopt the ICGN Principles. Each corporation should disclose the code that is applicable to it, whether it is complied with and, where not, the reasons for non-compliance. Institutional investors should give due and informed consideration to explanations given by corporation for such non-compliance.

8.2 Resolution of Governance Issues: Corporate governance issues between shareholders, the board, and management should be addressed through dialogue and, where appropriate, with government and regulatory representatives as well as other concerned bodies, so as to resolve disputes, if possible, through negotiation, mediation or arbitration. Where those means fail, more forceful actions should be available. For instance, investors should have the right to sponsor resolution and/or convene extraordinary meetings.

⁴ CalPERS recommends that corporations adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates.

⁵ CalPERS recommends that corporations adopt the Global Reporting Initiative Sustainability Reporting Guidelines to disclose economic, environmental, social, and governance impacts.

B. CORPORATE GOVERNANCE PRINCIPLES for EMERGING MARKETS

Shareowners can be instrumental in encouraging responsible corporate citizenship. CalPERS believes that environmental, social, and corporate governance issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, and asset classes through time.) Therefore, CalPERS joined 19 other institutional investors from 12 countries to develop and become a signatory to The Principles for Responsible Investment (Appendix B).

CalPERS expects developed and emerging economy companies whose equity securities are held in the Fund's portfolio to conduct themselves with propriety and with a view toward responsible corporate conduct. If any improper practices come into being, companies should move decisively to eliminate such practices and effect adequate controls to prevent recurrence. A level of performance above minimum adherence to the law is generally expected. CalPERS believes that Boards that strive for active cooperation between corporations and stakeholders⁶ will be most likely to create wealth, employment and sustainable economies.

CalPERS recognizes that adopting formal corporate governance principles, such as the ICGN Principles, may not be appropriate for every company in emerging capital markets due to differing developmental stages, ownership structure, regulatory structure, competitive environment, or a myriad of other distinctions. However, with adequate, accurate, and timely disclosure of environmental, social, and governance practices, shareowners are able to more effectively make investment decisions by taking into account those practices.

Good governance and sustainable development are mutually achievable. While companies in emerging markets should strive to meet the governance practices presented by the ICGN Principles, CalPERS recommends those emerging markets companies focus first and foremost on practices that promote economic, environmental, and social sustainable development. Thus, companies in emerging capital markets should formalize a reporting mechanism by which sustainable development practices can be disclosed to stakeholders, including shareowners.

CalPERS recommends companies in emerging markets adopt the following:

1. Corporate Economic, Environmental, and Social Responsibility Sustainability Reporting Guidelines: Corporations strive to measure, disclose, and be accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development. It is recommended that corporations

⁶ In accordance with the Global Reporting Initiative: Stakeholders are defined broadly as those groups or individuals: (a) that can reasonably be expected to be significantly affected by the organization's activities, products, and/or services; or (b) whose actions can reasonably be expected to affect the ability of the organization to successfully implement its strategies and achieve its objectives.

adopt the Global Reporting Initiative Sustainability Reporting Guidelines⁷ to disclose economic, environmental, and social impacts.

IV. CONCLUSION

By adopting the Global Principles of Accountable Corporate Governance, CalPERS strives to influence the market through advancing the corporate governance dialogue while also providing an educational forum by representing a foundation for accountability between a corporation's management and its owners. With continued experience and communication between corporate managers and owners, the issue of accountability can become — if not resolved — more clear.

————— *“As conflict — difference — is here in the world, as we cannot avoid it, we should, I think, use it. Instead of condemning it, we should set it to work for us... So in business, we have to know when to ... try to capitalize [on conflict], when to see what we can make it do.... [In that light] it is possible to conceive of conflict as not necessarily a wasteful outbreak of incompatibilities but a normal process by which socially valuable differences register themselves for the enrichment of all concerned.... Conflict at the moment of the appearing and focusing of difference may be a sign of health, a prophecy of progress.”*

THE PRICE WATERHOUSE CHANGE INTEGRATION TEAM, THE PARADOX PRINCIPLES 275 (quoting Mary Parker Follett) (1996).

⁷ Adoption of the Guidelines will provide companies with a reporting mechanism through which to disclose economic, environmental, social, and governance practices. The Guidelines along with additional information on GRI can be found at www.globalreporting.org.

ICGN Remuneration Guidelines Approved July 7, 2006

Executive Summary

Institutional investors have both a fiduciary responsibility and an economic interest in ensuring that executive remuneration or compensation is well aligned with their interests. The ICGN maintains current and relevant guidelines regarding the process of awarding remuneration and key plan design features to help communicate investors' perspectives on this critical issue. These guidelines update existing ICGN policy and provide further detail in line with recent events⁸.

Three principles underpin these updated guidelines: *transparency*, so investors can clearly understand the program and see total pay; *accountability*, to ensure boards maintain the proper alignment in representing owners in part by obtaining shareowner approval of a remuneration report; and *performance-based*, so the programs are linked to relevant measures of company performance over an appropriate timescale. This should also reflect due regard for the reputational aspects of remuneration.

The ICGN believes boards and their mechanisms for deciding upon executive pay play a critical role in representing owners in the process of remuneration design and oversight. It is therefore critical that they adhere to best practices in regard to their process, and that they ensure the relevance, independence, and pertinence of all supporting advisors and material used in setting remuneration programs.

The board is responsible for providing full and complete disclosure of the company's program, with particular emphasis on providing the rationale behind the plan design and how the components of the plan are integrated into an overall remuneration philosophy. The ICGN believes companies should provide a full explanation of the relationship of the plan to performance measures, and should include specific performance targets or hurdles. Boards will adopt different decision making processes for agreeing executive remuneration, be this through remuneration committees, the supervisory board, or sub-groups. The key point is that the mechanism is fully accountable to the governing body and its operation is, and is seen to be, independent and fair.

The ICGN believes plan design should carefully consider the major elements of compensation (cash and short-term incentives, equity and long-term incentives, and post-employment and other benefits), and carefully construct the program to fit the individual circumstances of each company. Accordingly, the ICGN believes the influence of benchmarking or peer relative analysis in establishing compensation levels should be kept to a minimum. The ICGN believes employment contracts, severance, and change in control agreements should be strictly limited, and any use of these tools should be justified within the context of the remuneration philosophy and overall plan design.

Remuneration has an important role in a company's ability to recruit and retain the executive talent it needs to ensure success. It also has the potential to damage reputation, affect employee morale and affect behaviour. Getting the balance on time scale and appropriate

⁸ The Caucus Race: Executive Remuneration, 2002.

performance measures is critical. These updated guidelines on remuneration are intended to provide a global benchmark to help shareholders and boards achieve this balance.

Introduction and Purpose

The traditional view of executive remuneration or compensation is to attract and retain qualified personnel. While true in simple terms, this definition fails to consider the significance of compensation programs in the overall governance of organizations. For long-term investors, a much broader view of remuneration is required that encompasses proper alignment, incentives to pursue optimal capital allocation and good corporate governance.

Investors have taken an increased interest and more active role in remuneration in recent years for several reasons. First and foremost, institutional investors have a fiduciary responsibility to act in the best interest of their beneficiaries, and executive remuneration is an important cornerstone.

Secondly, because remuneration programs have such a significant impact on the alignment and incentives of management, they are inexorably linked to the long-term viability of the company. Well designed remuneration programs have a demonstrable positive impact on the long-term performance of the company. Conversely, poorly designed or poorly executed compensation plans can have a serious negative impact on shareowner value. In this regard, the opportunity for a significant principal/agent problem arises. Thus, investors have a clear economic interest in addition to a fiduciary interest in the design and implementation of remuneration plans. The combination of these drivers give owners, particularly long-term owners, a role in setting broad policies and guidelines related to executive remuneration and in overseeing the practices of companies in this area through such means as proxy voting and direct engagement.

These guidelines are primarily addressed to companies and their non-executive or supervisory board members, and set out key remuneration principles which should be applied by companies regardless of their domicile. They cannot address every issue related to remuneration. Rather, they reflect the overall policy and philosophical approach to remuneration that leading institutional investors and their associations expect from companies. In this regard, the guidelines set out general principles that reflect best international practice. They should be applied pragmatically, taking into account the specific circumstances of each company and the economic and legal environment in which it operates.

The ICGN believes that best practice in remuneration begins with the formation of an independent and effective process for deciding upon executive remuneration. In many jurisdiction companies have established remuneration committees, comprising independent non-executive or supervisory board members, who can take responsibility for proposing remuneration for approval by the whole board. The purpose of such a committee is to ensure independence and focus in the process. The overall concepts in these guidelines apply regardless of the particular mechanism which is chosen. The important point is that the company establish a formal, independent process for setting remuneration, which is wholly transparent and accountable to shareowners. Any such remuneration committee is considered complementary to the board, and does not remove ultimate responsibility for the full board regarding proper remuneration. For convenience, we term this decision making body a 'remuneration committee', although terms may differ across markets.

The ICGN's guidelines are intended to serve as a communication tool from investors to companies in any domicile and any industry. The ICGN believes remuneration programs should be carefully designed and implemented with the unique situation of each company in mind. However, we believe certain broad principles and guidelines are universal. Within this framework, we recognize the need for flexibility to tailor remuneration programs to meet the challenges and opportunities that each company faces. With this flexibility, it is incumbent upon the company to properly structure a remuneration committee, develop and implement processes for setting remuneration programs, and provide full disclosure of remuneration programs, including all aspects ranging from the philosophy to details of individual executive pay elements.

1.0 Role of the Remuneration Committee

- 1.1 The remuneration committee is responsible for all aspects of the remuneration program. The committee should take ownership of devising, drafting and implementing the remuneration program.
- 1.2 The committee should be sufficiently independent in its makeup and process to completely fulfill its role in administering a remuneration program in the best long-term interests of shareholders. Ideally, the committee should comprise entirely independent non-executive directors or supervisory board members. However, depending on best practice in the relevant market, a clear majority of its members should be independent. Special care should be taken to ensure that the committee as a whole has adequate experience and background as well as diverse perspectives. The committee should consist of at least three members. The ICGN is aware that current CEOs of other companies may have a potential conflict or bias in setting their peers' remuneration, yet can also have valuable insights into remuneration issues. The ICGN believes committees should carefully consider the role of other CEOs in the remuneration setting process and should limit the number of CEOs on the committee to ensure independent thinking prevails.
- 1.3 The committee should have available the necessary resources to fulfill its duties and obligations. This includes controlling all aspects of the engagement of specialist remuneration consultants, including their selection, engagement, and release. Special care should be taken to avoid conflicts of interest that would impair the independence of the consultants. For example, the committee's consultant would not be considered independent if they are also currently engaged by the company's management.
- 1.4 The committee has the responsibility to integrate all components of remuneration into a cohesive program that supports and is tied to the objectives of the company, which may be both short-term and long-term in nature. Performance measures should include appropriate financial targets, but non-financial targets may also be highly relevant to long-term sustainable commercial success.
- 1.5 In establishing the remuneration program and evaluating appropriate forms as well as levels of remuneration, the committee should take into account all relevant information. This may include the use of peer relative analysis and benchmarking to peer and market examples. However, care should be taken not to over-emphasize the influence of peer group benchmarking on the ultimate design of the program.

Peer group averages alone are not adequate justification for the design of a remuneration program or the levels of pay. Rather, each company's remuneration program should be carefully designed to fit its unique situation.

- 1.6 It is the committee's responsibility to maintain appropriate communication with shareholders, either directly or via the board. This includes a responsibility to provide full disclosure regarding the remuneration program, as well as maintain a dialogue and seek input from shareowners as appropriate.

2.0 Remuneration Plan Design

- 2.1 The ICGN believes remuneration plans should be structured with an appropriate balance of short-term and long-term incentives. This ratio may vary based on market conditions and the specific circumstances of the company. It is incumbent upon the committee to carefully evaluate all relevant information in establishing the desired mix of short-term and long-term remuneration elements, and update this evaluation over time to ensure that the plan evolves to meet the company's changing situation.

- 2.2 The ICGN believes remuneration plans should be strongly linked to the company's performance that reflects and is consistent with value to long-term shareowners. It is acceptable to provide incentives to achieve both long-term and short-term goals; however, the performance drivers should not be duplicative, and a balance needs to be struck with the need to reward success over the long-term.

- 2.3 The remuneration committee should establish goals for total remuneration, as well as each major sub-component of the plan. This should be done in the context of a total compensation analysis, and committees may use tools such as tally sheets to gain a complete perspective of the remuneration program. This will help the committee evaluate the overall mix of remuneration and determine how to integrate the elements. Remuneration levels may take into account relevant benchmarks and market conditions, but these criteria should not be used exclusively to justify levels of remuneration or plan design. Too much reliance on peer relative analysis leads to unjustified escalation in executive pay that gives rise to concern. Each plan should be tailored to the unique circumstances of the company as well as the responsibilities of the position(s) in question and the experience and expertise of the individual.

- 2.4 Compensation plans generally consist of four primary categories: cash and short-term incentives; equity and long-term incentives; retirement and post-employment benefits and "other" compensation, such as perquisites.

2.4.1 Cash and Short-Term Incentives:

The cash component and short-term incentives should generally be tied to annual performance measures. Objectives should be set and recorded at the beginning of the performance period. Companies should disclose the circumstances in which short-term performance measures may be adjusted, including the process and timing of disclosure of these actions. The ICGN believes short-term performance measures should not be adjusted after a brief period of the performance horizon has past, such as the first quarter for

example, regardless of the circumstances. Companies should avoid performance periods shorter than 1 year (such as quarterly bonus programs).

2.4.2 Equity and Long-Term Incentive Tools.

The equity and long-term incentive component should consist of an appropriate mix of equity and equity like tools, which may include options, restricted shares, stock appreciation rights, and other equity-like incentive structures for example. The ICGN believes companies should provide clear justification for the types of equity tools employed and the relative mix of these tools.

Companies should provide a clear plan (contained within the remuneration report or other disclosures) that details how these tools will be used including the target dilution levels, cumulative dilution to date, and projected run rates over a multi-year period and actual run rates over previous years. This justification should include the methodology by which companies will determine the appropriate dilution and run rate, and evaluate the effectiveness of the plan over time, including its impact on long-term value creation. The equity plan should also include a maximum annual limit on individual participation and the planned distribution of equity tools (In other words, distribution between the executive ranks and employee base including the rough percentage of the overall plan that will go to each group).

Any potential dilution of shareowners should require prior approval through votes to protect pre-emption rights.

The ICGN believes equity ownership guidelines and holding requirements should be an integral component of company's equity plan and overall compensation philosophy. Equity ownership guidelines are generally expressed as a multiple of salary and bonus opportunity, and serve to align the interests of the management team with the long-term owners. Accordingly, the guidelines should require significant ownership levels over an appropriate period of time. Holding requirements generally require that executives shall hold significant portions of equity grants for extended periods, which should include requirements to hold some portion of grants for a fixed period of time after separation (such as retirement or other event in which employment is ceased).

The ICGN believes the following equity plan characteristics are inappropriate: discount options; re-load provisions; gross-up provisions; accelerated vesting upon change in control; and, repricing without shareholder approval. Companies should also provide clear guidance regarding the circumstances under which key plan criteria may be amended, including performance targets, and including notification to shareowners (disclosure).

Equity (and equity-like) remuneration should have vesting terms that are clearly consistent with the company's capital allocation and investment horizon. The ICGN believes that, as a general rule, vesting of long-term incentives should be a minimum of three years.

The ICGN is opposed to share repurchase plans that are strictly designed to offset equity plan dilution. Share repurchase plans should be an integral component of the company's capital allocation decision, not its remuneration program. Share repurchase plans designed to offset equity plan dilution may lead to poor capital allocation decisions or poor timing of repurchase activity.

Equity grants should be scheduled at regular annual intervals. Companies should adopt and disclose a formal pricing methodology for establishing the strike price of grants where applicable. For example, this may entail a policy of establishing the strike price at the average closing price of the company's common shares over the previous 2 to 4 week period. In no circumstances should boards or management be allowed to back date grants to achieve a more favorable strike price (in the case of options).

2.4.3 Performance-Based Methodologies.

The ICGN strongly supports the use of performance measures tied to the vesting of equity and equity-like instruments. This may include indexing or premium pricing methodologies⁹ and other performance criteria such as key operational metrics. The ICGN does not support time accelerated vesting¹⁰ as a legitimate or desirable performance vesting methodology.

Performance targets associated with equity components should be consistent with long-term sustained superior performance. This means that performance goals should be constructed to measure sustained performance over long periods (including multiple accounting periods). Care should be taken to mitigate potential unintended negative incentives that may be associated with performance measures. For example, poorly constructed performance programs could provide an opportunity to manipulate short-term accounting measures to meet performance goals.

The ICGN believes plans should be designed to minimize or eliminate potential adverse incentives in the following ways (at a minimum): a) Utilize multiple performance metrics with some offsetting drivers that would mitigate the ability to manipulate accounting measures or drive poor business decisions to reach goals (for example, if revenue growth is a desired performance target, it should be accompanied by a profitability or margin measure to ensure that the "incentive" is not to increase revenue at any cost); b) Utilize performance methodologies that encompass multiple periods, such that no opportunity to manipulate one accounting period over another exists (channel stuffing or expense shifting for example); c) Utilize varied performance metrics over time (perhaps with each year's grant) in an effort to evolve the program with the company's situation and provide diversified performance drivers; and d) companies should adopt a

⁹ Indexing and premium pricing methodologies are forms of performance-based vesting. Indexed stock options have a strike price set relative to a peer group index such that the strike price is adjusted to reflect the performance of the index. Premium priced options have a strike price set at a premium to the current market at the time they are granted.

¹⁰ Time accelerate vesting is a methodology that accelerates the vesting of an equity award based upon meeting some pre-determined criteria or performance hurdle. Under time accelerated vesting, the equity awards will vest eventually vest even if the performance criteria for acceleration are not met, the performance criteria is tied only to the acceleration of vesting.

~~“clawback” policy that provides for the recapture of performance related pay in cases of restatement or fraudulent reporting if either resulted in an award of performance-based remuneration.~~

~~In change in control or other corporate events the ICGN believes only pro-rata performance criteria that reflect a real measure of underlying achievement should be awarded. The ICGN is opposed to a blanket acceleration of equity instruments based on corporate events. The remaining equity instruments and performance awards should be tied to the long-term success of the new entity, not the execution of the transaction.~~

~~The ICGN does not favor “retesting” or granting of additional time to meet performance goals except in very exceptional circumstances. The company should have a clearly articulated policy on how these considerations will be made and how the company will disclose any material changes to terms of the remuneration plan.~~

2.4.4 Post Employment and Other Benefits

~~Post employment and other benefits include retirement arrangements (both defined benefit and defined contribution plans), health care, and other benefits such as perquisites (both during and after employment). Should companies utilize any of these forms of remuneration, care should be taken to integrate these structures within the overall philosophy and structure of the total plan. Post employment and other benefits can entail significant liability for the company and may represent significant portions of the total value of the remuneration program. As such, the alignment and incentive characteristics of these elements of the remuneration plan can have a material impact on its overall effectiveness. As a general rule, the ICGN believes post employment benefits and perquisites may significantly detract from the performance and alignment qualities of remuneration plans, while arguably having some value to attract and retain key employees. These competing interests must be balanced strictly in the best long-term interests of the shareholders.~~

~~As noted under Section 2.1 and 2.2, the company should disclose all material aspects of the remuneration plan, which includes post employment and other benefits. The ICGN believes companies should disclose the existence of all retirement programs for executives, clearly noting any supplemental benefits or sweeteners provided (such as above market earnings on account balances or additional years of service credit for example). Disclosures related to defined benefit programs should include an estimate of the actuarial present value accrued during the applicable year, and an estimate of the expected benefit at normal retirement age. These disclosures should be specific to each individual executive covered in the disclosures.~~

~~If any portion of post employment benefits (retirement, health, perquisites) is unfunded, the company should provide adequate detail as to the potential liability to the company under these programs.~~

3.0 Employment Contracts, Severance, and Change in Control Agreements

- ~~3.1 The ICGN believes contracts, employment agreements, severance, and change in control arrangements should be strictly limited. As a rule, these arrangements should not adversely affect the executive's alignment of interest with shareowners or their incentive to pursue superior long-term value.~~
- ~~3.2 Employment contracts should not extend longer than 1 to 3 year periods, and should not be open-ended or renewed on an "automatic" basis. Contracts that run for a multi-year period for the purpose of recruitment should revert to a 1 year contract after the initial contract period. Within this, boards should pursue a policy of mitigation to minimize post-employment expenses to executives.~~
- ~~3.3 Employment arrangements should not provide guaranteed raises, bonuses, or other incentives such as equity grants. Such provisions have a negative impact on the alignment and incentive characteristics of the remuneration program.~~
- ~~3.4 Severance payments should be limited to situations of wrongful termination, death, or disability.~~
- ~~3.5 The ICGN believes companies should not utilize change in control agreements or make special arrangements in the event of an equivalent corporate event. Change in control agreements can have a significant detrimental impact on the alignment and incentives of the management team. These arrangements typically tie significant remuneration to the transaction in the form of cash payouts, accelerated vesting of equity, and other benefits that are not well aligned with the long-term interests of the owners or with the success of the new entity.~~
- ~~3.6 Companies should not compensate executives for any excise or additional taxes payable as a result of any employment, severance, or other agreement.~~
- ~~3.7 Companies should provide full disclosure of the existence of all employment agreements, severance arrangements, change in control agreements, or any other contractual agreements with key executives. Disclosure should include a description of the agreements with sufficient detail of all material factors such that shareowners have a complete understanding of their terms. Companies should provide estimated payments under specific scenarios such that shareowners can determine the potential payouts under each agreement.~~

4.0 Disclosure

- ~~4.1 The committee is responsible for providing full disclosure to shareowners and the market of all aspects of the committee's structure, decision making process, and the remuneration program.~~
- ~~4.2 The committee should provide disclosure on at least an annual basis that provides a detailed explanation of the remuneration program. This report should include the company's rationale for the program, including the company's overall remuneration philosophy and how the program is designed to support the company's business~~

objectives. The report should also provide detailed disclosures of the remuneration of each key executive.

- Each component of the remuneration program should be identified and its role in the overall compensation program should be justified and explained. This disclosure should include the relative mix of compensation (cash, equity, retirement benefits, perquisites, and other forms of reward) as well as an explanation of how each fits into the performance objectives of the plan. The disclosures should also provide detail on any tax related payments, and favorable treatment provided to executives (such as low rate loans, forgivable loans, or preferential earnings rates).

The report should be detailed enough to allow shareholders to evaluate the minimum and maximum value of remuneration packages in total under different performance scenarios. This should include disclosure of the potential maximum and expected value of performance related remuneration components, and an explanation of the methodology for estimating the expected value.

- If the company utilizes any form of employment agreements, change in control agreements, or other contractual arrangements, these should be fully disclosed. The disclosures should include the key terms of these arrangements and the rationale for their use. Care should be taken to articulate how these arrangements are in the best interest of the owners and tied to the long-term performance of the company, if at all.

4.3 Special care should be taken in the remuneration report to provide a full explanation of the relationship of the plan to performance measures. It is the committee's responsibility to integrate all the components of the plan and ensure that the plan as a whole is sufficiently tied to long-term sustained superior performance. The remuneration report should include evidence of the committee's actions in this regard. Any benchmarks or other hurdles contained in the plan or utilized to establish plan design should be disclosed. As a general rule, the ICGN believes companies should disclose performance targets and hurdles at the time they are established, such as when annual cash incentive plans are implemented or when equity grants are made.

4.4 In cases where disclosure of performance hurdles at grant date would divulge commercially competitive information, the company should provide full disclosure of the targets upon measurement or realization of the performance period instead of at grant date.

4.5 The company should obtain shareowner approval of the remuneration report, a remuneration policy, or similar comprehensive disclosure as may be appropriate in the applicable jurisdiction. The purpose of obtaining shareholder approval is to provide owners with an opportunity to formally express their opinion regarding the performance of the company in regards to designing and implementing a remuneration program that is in shareowners' interests. In some cases, approval of a remuneration report is required by regulation or advised by market codes of best practice.

- 4.6 Disclosures should be presented in a single location and in a clear and understandable format. To the degree possible, tabular disclosures supported by narrative descriptions should be used to organize information.
- 4.7 The committee or if appropriate in the relevant market, the board, should seek and maintain a constructive dialogue with shareholders and should seek input regarding key elements of remuneration philosophy or plan design.

Sources

Association of British Insurers, *Principles and Guidelines on Remuneration* (December 2004)
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Performance Pay Group, *Guidance on Remuneration Policy* (December 2004)
TIAA-CREF, *Policy Statement on Corporate Governance* (2004)
London Stock Exchange, *Corporate Governance—A Practical Guide* (2004)
Council of Institutional Investors, *Corporate Governance Policies*

Principles for Responsible Investment

Launched in April 2006, The Principles for Responsible Investment (PRI) provides the framework for investors to give appropriate consideration to environment, social and corporate governance (ESG) issues. The PRI was an initiative of the UN Secretary General and coordinated by UNEP Finance Initiative and the UN Global Compact. An international working group of 20 institutional investors was supported by a 70-person multi-stakeholder group of experts from the investment industry, intergovernmental and governmental organizations, civil society and academia. CalPERS is one of the original signatories.

The Principles

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.

Additional information can be found at www.unpri.org.